

**Letter of Findings: 08-0532**  
**Indiana Corporate Income Tax**  
**For the Tax Year 2002-2006**

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**ISSUE**

**I. Adjusted Gross Income Tax—Imposition.**

**Authority:** IC § 6-3-2-2; IC § 6-3-4-14; IC § 6-8.1-5-1; [45 IAC 3.1-1-111](#).

Taxpayer protests the Department's decision to exclude two of its subsidiaries.

**STATEMENT OF FACTS**

Taxpayer manufactures research equipment and engages in pre-clinical testing and clinical research. Taxpayer consists of an Indiana parent corporation, one Indiana subsidiary, and two out-of-state subsidiaries. The two out-of-state subsidiaries engage in pre-clinical research at facilities located in Oregon and Maryland. Taxpayer filed consolidated Indiana adjusted gross income tax returns for the 2002 to 2006 tax years and included the two out-of-state subsidiaries as part of the consolidated group. After an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for additional adjusted gross income tax for the 2002 through 2006 tax years. The Department removed Taxpayer's two out-of-state subsidiaries, which did not have Indiana source income from Taxpayer's consolidated returns. Taxpayer protested the assessment. An administrative hearing was held, and this Letter of Findings results.

**I. Adjusted Gross Income Tax—Imposition.**

**DISCUSSION**

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department removed two of Taxpayer's out-of-state subsidiaries that did not have Indiana source income from Taxpayer's consolidated adjusted gross income tax returns. The two subsidiaries were excluded from the returns because they did not meet the Indiana source income requirement found in IC § 6-3-4-14. The two out-of-state subsidiaries reported zero Indiana property, payroll, and sales.

Taxpayer maintains that it included the two out-of-state entities in its Indiana consolidated adjusted gross income tax returns because it was filing a "nexus consolidated return." While the Department is not familiar with a "nexus consolidated return," certain affiliated taxpayers are permitted to file "consolidated returns."

Pursuant to IC § 6-3-4-14(a)-(b), "[A]n affiliated group of corporations shall have the privilege of making a consolidated return with respect to the taxes imposed by [IC 6-3...](#) with the exception that the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana." (Emphasis added). This is further explained in [45 IAC 3.1-1-111](#), which states in relevant part:

The Adjusted Gross Income Tax Act adopts the definition of "affiliated group" contained in Internal Revenue Code section 1504, except that no member of the affiliated group may be included in the Indiana return unless it has adjusted gross income derived from sources within the state, as that phrase is defined in [IC 6-3-2-2](#). For purposes of this subsection, "Adjusted Gross Income derived from sources within the state" means either income or losses derived from activities within the state.

IC § 6-3-2-2(a), in relevant part, defines "adjusted gross income derived from sources within Indiana," as follows:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation from a trade or profession conducted in this state; and
- (5) income from stocks, bonds, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. (Emphasis added).

Accordingly, if a taxpayer has business income that is earned from sources within and without the state, only the amount of such income that is apportioned to Indiana with the property, payroll, and sales factors found in 6-3-2-2(b) is deemed to be derived from Indiana sources. Therefore, since the out-of-state subsidiaries have zero

Indiana property, payroll, and sales factors, the subsidiaries' business income times zero results in the subsidiaries having no income that is derived from Indiana sources.

Taxpayer maintains that its out-of-state subsidiaries lack of Indiana property, payroll, and sales factors does not matter. During the course of the protest, Taxpayer stated that "although [the two out-of-state subsidiaries] do not perform testing in Indiana, employees of an affiliated company perform revenue generating services in Indiana" for the out-of-state subsidiaries creating nexus. In effect, Taxpayer is asserting that the out-of-state subsidiaries—which have no payroll, property, or sales of their own in Indiana—can acquire nexus through the activities performed by its affiliates that do have nexus in Indiana. However, this cannot be the case because of the statutory prerequisite that each entity in the consolidated group have income derived from Indiana sources as provided in IC § 6-3-4-14.

Seemingly, Taxpayer is making an argument that a taxpayer seeking to file a combined return would make in a petition to the Department as provided in IC § 6-3-2-2(l), (q). Under IC § 6-3-2-2(l), if a taxpayer feels the "the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for... the employment of [another] method to effectuate an equitable allocation and apportionment of the taxpayer's income." (Emphasis added). While Taxpayer argues that the activities it listed in its protest support Taxpayer's "unitary status," the issue here is consolidated returns, not combined returns. Consolidated returns include affiliated entities with Indiana source income. Taxpayer's listed activities do not show income, Indiana or otherwise, to the excluded entities, therefore, the activities are not eligible for consideration under IC § 6-3-4-14(a) and [45 IAC 3.1-1-111](#).

#### **FINDING**

Taxpayer's protest is denied.

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